



REGIONAL CENTERS & SPONSORS AND U.S. SECURITIES LAWS

**How to evaluate broker-dealer, investment company
and investment adviser registration requirements**



Catherine DeBono Holmes, Esq.
Chair, Investment Capital Law Group
Jeffer Mangels Butler & Mitchell LLP

Victor T. Shum, Esq.
Chief Executive Officer
Advantage America EB-5 Group





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A joint publication of the JMBM Investment Capital Law Group
and Advantage America EB-5 Group

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Preface

The information in this booklet was first published as a four-part series of articles on the Investment Law Blog under the title, “How EB-5 Regional Centers and Sponsors Can Evaluate Broker-Dealer, Investment Company and Investment Adviser Registration Requirements under U.S. Securities Laws.”

We wrote these articles in response to the hundreds of queries we have received from EB-5 professionals and developers regarding requirements set forth by the U.S. Securities and Exchange Commission (SEC). While the SEC provides clear guidance in some areas, it provides very little in others, so knowledgeable attorneys must carefully guide their clients through the thicket of requirements.

Our perspective is based on many years of investment law experience, including acting as securities counsel on a wide range of investments, both private and public. We also have many years of experience in the EB-5 arena, representing numerous clients on projects funded in part through EB-5 financing.

We acknowledge the many dedicated and knowledgeable EB-5 professionals, in both the U.S. and China, who have provided us with challenging questions, interesting work, and the opportunity to participate in the dynamic EB-5 community. We appreciate their trust, confidence and friendship and commit ourselves to help all involved, including regional centers, sponsors, developers, and investors – resident in the U.S., China and elsewhere – to reach their goals through the EB-5 program.

We invite you to contact us with your questions and comments.

Catherine DeBono Holmes

CHolmes@jmbm.com

+1-310.201.3553

Victor T. Shum

vshum@aaeb5.com

+1-415.886.7486

About the Authors



Catherine DeBono Holmes is the chair of JMBM's Investment Capital Law Group, and has practiced law at Jeffer Mangels Butler & Mitchell for over 30 years. She helps clients worldwide to raise, invest and manage capital from U.S. and non-U.S. investors and specializes in EB-5 immigrant investment offerings and hotel and real estate transactions made by Chinese investors in the U.S. She has represented more than 50 real estate developers in obtaining financing through the EB-5 immigrant investor visa program for the development of hotels, multi-family and mixed-use developments throughout the U.S., and has represented numerous Chinese investors in the purchase of hotels and businesses in the U.S. Within the Investment Capital Law Group, Cathy focuses on business formations for entrepreneurs, private securities offerings, structuring and offering of private investment funds, and business and regulatory matters for investment bankers, investment advisers, securities broker-dealers and real estate/mortgage brokers. She holds a J.D. from Boalt Hall School of Law, University of California, Berkeley and a B.A. from the University of California, Berkeley (Phi Beta Kappa).



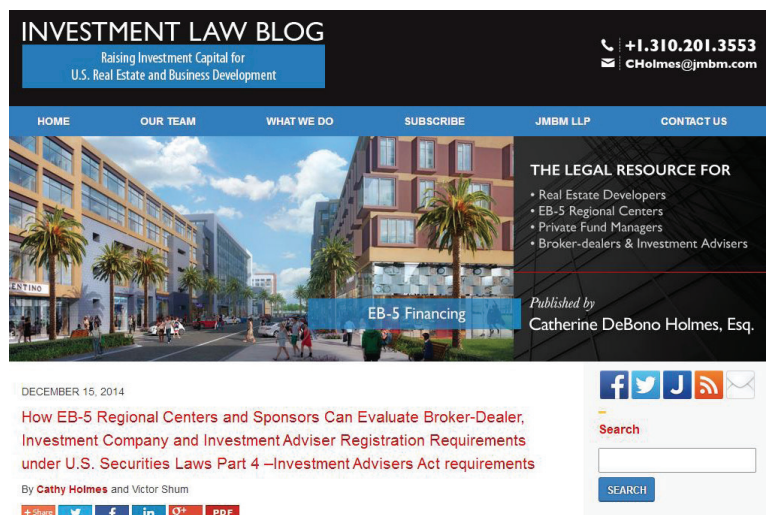
Victor T. Shum is the Chief Executive Officer of the Advantage America EB-5 Group (aaeb5.com) which manages the USCIS approved Advantage America California Regional Center, LLC and Advantage America New York Regional Center, LLC and an expanding portfolio of regional centers across the country. He was previously a corporate and securities partner at the law firm of Jeffer Mangels Butler & Mitchell LLP. Victor has significant experience advising clients on cross-border transactions, including representing private equity funds, public and private companies in inbound and outbound transactions with China, and representing high-net worth individuals, real estate developers, banks and USCIS regional centers with the EB-5 immigrant investor program, a topic in which he is a frequent publisher and speaker. Victor holds a B.S. in Materials Science & Engineering from the University of California, Berkeley and a J.D. from the University of California Hastings College of the Law. Victor has also studied at Peking University and the University of Hong Kong.

About the Investment Law Blog

We invite you to read our many articles about EB-5 financing, investment and development on the Investment Law Blog at www.InvestmentLawBlog.com.

Subscriptions to the blog are complimentary and you will be notified, via email, when new blogs are posted. Subscribe at www.investmentlawblog.com/subscribe.

We invite you to contact us to discuss how the issues we write about might impact your EB-5 project.



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Raising Investment Capital for
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+1.310.201.3553
cHolmes@jmbm.com

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
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How EB-5 Regional Centers and Sponsors Can Evaluate Broker-Dealer, Investment Company and Investment Adviser Registration Requirements under U.S. Securities Laws Part 4 –Investment Advisers Act requirements

By **Cathy Holmes** and Victor Shum

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Part I:

EB-5 offerings do not fit standard SEC registration requirements



EB-5 offerings do not fit standard SEC registration requirements

The SEC has not provided clear guidance on how to comply with U.S. securities laws requiring registration as a securities broker-dealer, investment company or investment adviser when conducting EB-5 offerings.

The U.S. Securities and Exchange Commission (SEC) has stated in open meetings with the United States Citizenship and Immigration Services (USCIS) and the Association to Invest In the USA (IIUSA), the trade association for the EB-5 regional center program, over the past two years that EB-5 investment offerings are subject to U.S. securities laws, even though EB-5 investments are offered primarily outside the United States to persons who by definition are not currently U.S. residents but are seeking to become U.S. residents as a result of making their investment in an EB-5 offering. However, the SEC has not provided any specific guidance to the EB-5 investment community on the ways in which they can comply with the registration requirements that apply to the registration requirements for securities broker-dealers, investment companies or investment advisers under U.S. securities laws, other than to suggest that they speak to an experienced securities lawyer. This advice leads to conflicting opinions among lawyers, and makes it difficult for everyone involved in the EB-5 investment market to know exactly what they are required to do in order to comply with these registration requirements under U.S. securities laws.

There is an important distinction between SEC jurisdiction over cases of investor fraud versus the requirements for registration of broker-dealers, investment companies and investment advisers

The SEC has brought several actions against EB-5 regional center operators in cases of investor fraud. Notably, the SEC brought a securities fraud enforcement action against A Chicago Convention Center, LLC, Anshoo Sehti and Intercontinental Regional Center Trust of Chicago, LLC in 2013 (Civil Action No. 13-cv-982), in a case where the defendants had committed fraud by misrepresenting that they had all necessary building permits and contracts with several major hotel chains when they had none, substantially overstating the value of the land on which the

project would be built, and making false claims regarding the experience of the principals in developing and operating hotels. Since then, the SEC has brought several other actions against EB-5 regional center operators who did not invest funds in the projects for which the EB-5 offerings were made. In all of these cases, the fraudulent conduct of the defendants was obvious, and the SEC rightfully exerted jurisdiction to protect EB-5 investors and strengthen the integrity of the EB-5 investment program. In this respect, the EB-5 community supports the actions of the SEC, because it ultimately benefits the market for EB-5 investments to have a strong enforcement policy against fraud in the EB-5 investment market.

The United States District Court for the Northern District of Illinois, in the case brought by the SEC against A Chicago Convention Center, LLC, Anshoo Sehti, and Intercontinental Regional Center Trust of Chicago, LLC, ruled on August 6, 2013 that the SEC had adequately alleged a domestic securities transaction, as required to state a securities fraud claim. The court in that case focused on the connections between the EB-5 investment offering and the U.S., including that the subscription agreement was required to be delivered by EB-5 investors to defendants in the U.S., the offering funds were sent to a U.S. based escrow agent, the escrow agent would only release funds upon approval of the investors' U.S. visa applications, and the investors were bound only if the subscription agreement was accepted and countersigned by the manager of the EB-5 investment Fund in the U.S. The court found that these connections could be enough to meet the "transactional" test adopted by the U.S. Supreme Court in the 2010 case of *Morrison v. National Australia Bank Ltd.*, which limits the SEC's jurisdiction to bring anti-fraud actions to claims that involve the purchase or sale of securities made in the U.S. or involving a security listed on a domestic exchange.

The court in the Chicago Convention Center Case further noted that there is a controversy whether Section 929P(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, entitled "Extraterritorial Jurisdiction of the Antifraud Provisions of the Federal Securities Laws," has superseded the "transactional" test in *Morrison*, but the court ultimately decided that it was unnecessary to rule on that question.

It cannot be assumed that because the SEC has jurisdiction to bring anti-fraud actions, this automatically means that all of the securities registration requirements apply to all EB-5 offerings

Whether the Morrison test has been superseded or not by Section 929P of the Dodd-Frank Act, it seems likely that any EB-5 offering would have enough connections with the U.S. to be subject to SEC anti-fraud actions. However, that does not answer the question of whether EB-5 offerings are subject to the registration requirements that apply to U.S. securities broker-dealers, investment companies and investment advisers. The vast majority of EB-5 regional center operators and EB-5 project sponsors have successfully raised billions of dollars for U.S. investment and created tens of thousands of jobs throughout the U.S. These EB-5 financing experts are seeking to operate their businesses legally, in a market outside the U.S., where market conditions require the use of foreign emigration agents and few U.S. securities broker-dealers have any experience. These unique market characteristics are not addressed in the SEC's existing regulations or policies regarding the registration requirements applicable to securities broker-dealers, investment companies and investment advisers.

The SEC has provided clear guidance on exemptions from registration of securities offered outside the U.S. – but not on exemptions from registration of securities broker-dealers, investment advisers and investment companies for offerings conducted outside the U.S.

Under Regulation S, the SEC has provided a safe harbor for any offerings conducted entirely outside the U.S. and offered to non-U.S. persons, providing that such offerings are not required to be registered with the SEC. Under Regulation D, the SEC has provided another safe harbor for private offerings conducted in the U.S. and offered to qualified U.S. and non-U.S. persons, providing that those offerings are not required to be registered with the SEC. Almost all EB-5 offerings are conducted under Regulation S and/or Regulation D, without SEC registration. These offerings are still subject to SEC enforcement action to the extent that a fraud is committed,

but they are not required to be registered with the SEC. Unfortunately, there are few such guidelines provided for EB-5 offerings with respect to the registration requirements for securities broker-dealers, investment companies and investment advisers.

Existing SEC regulations regarding registration of broker-dealers, investment companies and investment advisers do not address the market realities of EB-5 financing

There are three elements of the U.S. securities laws that are the cause of confusion and concern in the EB-5 investment community, which are: (1) the securities broker-dealer registration requirements under the Securities Exchange Act of 1934, (2) the investment company registration requirements under the Investment Company Act of 1940, and (3) the investment adviser registration requirements under the Investment Advisers Act of 1940. The problem is that each of these registration requirements was adopted specifically to address issues related to securities offerings made in the U.S. in traditional securities markets. The EB-5 financing market, in contrast, presents unique characteristics that are not present in traditional U.S. securities offerings, and that defy a clear answer under existing SEC regulations.

First and foremost, in determining the broker-dealer registration requirements to apply to the EB-5 investment market, it is necessary to take into account the fact that virtually all EB-5 investments are sold overseas, and that in China, where almost 85 percent of all EB-5 investments today are sold, sales are conducted through a network of licensed emigration agents and intermediaries that specialize in EB-5 investments but do not otherwise engage in a general securities business. At the present time, virtually none of these agents are associated with any U.S. securities broker-dealers. Almost all EB-5 investment sponsors will need to engage one or more of these agents directly in order to sell their EB-5 offerings.

Even if an EB-5 investment sponsor wanted to hire a U.S. broker, it would still need to hire one or more Chinese emigration agents to actually identify all of the investors necessary to fully fund an EB-5 offering being sold in China. U.S. securities brokers do not have the network of contacts or market experience to sell investments in China, and many choose not to do business at all in China. These are market realities that have to be taken into account when structuring guidelines for compliance with the broker-dealer requirements under U.S. securities laws.

In addition, the SEC has stated that the Investment Company Act of 1940 and Investment Advisers Act of 1940 may apply to EB-5 offerings, without considering the characteristics of an EB-5 investment fund. Specifically, most EB-5 investment funds are structured as an investment in one project, with no expectation of investing in any other projects. EB-5 investors typically decide for themselves which project they want to invest in, using the disclosure in the EB-5 offering documents concerning the project identified by each EB-5 investment fund. There is no such thing as a blind pool in EB-5 financing, because every investor is required to identify a single project (one project could have multiple components) on which their visa application will be based and this project is required not only to generate the requisite number of jobs per investor, but also to evidence its regional economic impact.

Moreover, the manager of an EB-5 investment fund has very limited discretion to do anything other than make the single investment described in the EB-5 offering documents with the investors' funds. Beyond that, the manager's role is limited to monitoring the project and providing information to investors regarding the completion of the project, tracking the creation of jobs, and making distributions of payments when the investment is repaid back to the EB-5 investors. Some EB-5 investment funds provide the manager with discretion to make another investment if the fund's investment is unexpectedly paid off early, but that is often done to protect the EB-5 investors' eligibility for approval of their I-829 visa petitions, because USCIS regulations require that the investors' funds be "at risk" until they receive approval of their I-829 petition.

These characteristics of an EB-5 investment fund are not well suited for regulation under the Investment Company Act of 1940, which was intended to regulate mutual funds whose managers have discretion to invest in securities of multiple issuers over a long period of time. In addition, given the extremely limited authority of the managers of almost all EB-5 investment funds, the Investment Advisers Act of 1940 would likely not apply because of the SEC's method of determining "assets under management."

How can EB-5 regional centers and sponsors comply with U.S. securities laws and thrive in the EB-5 investment market?

The SEC is still in the process of studying the EB-5 investment market, and we do not know when, if ever, the SEC will issue any guidance or policy decisions regarding the registration requirements that apply in the EB-5 investment market. In the meantime, the EB-5 investment community needs practical advice on how to comply with U.S. securities laws in a way that recognizes the realities of the EB-5 investment market. Based on our experience of helping more than 50 real estate developers and EB-5 investment sponsors obtain financing through the EB-5 immigrant investor visa program for developments throughout the U.S., the remainder of this booklet will focus on some thoughts on how to comply with the U.S. securities laws when selling EB-5 investments.

Part 2:

Securities broker-dealer registration requirements and hiring U.S. and Non-U.S. brokers



Securities broker-dealer registration requirements and hiring U.S. and Non-U.S. brokers

As mentioned in Part 1 of this booklet, *"EB-5 offerings do not fit standard SEC registration requirements,"* the Securities and Exchange Commission (SEC) is studying the EB-5 investment market – but there is no indication whether or when it will issue any guidance regarding the registration requirements applicable to the sale of EB-5 investments. At the May 2014 annual conference of the Association to Invest In the USA (IIUSA), the trade association for the EB-5 regional center program, representatives of both the SEC and the Financial Industry Regulatory Association (FINRA) gave presentations regarding the potential application of registration requirements to EB-5 regional centers and others engaged in the marketing and sale of EB-5 investments, but there was no indication that the SEC or FINRA had developed any policies specifically addressing the unique characteristics of the EB-5 market.

There are exemptions from broker-dealer registration that are available to EB-5 regional centers and entities which act as general partners or managers of EB-5 investment funds. In addition, there are exemptions that apply to non-U.S. broker-dealers in connection with the sale of U.S. securities that could be applied to the sale of EB-5 investments. However, there is a lack of clear guidance specifically applicable to the broker-dealer registration requirements that apply to persons engaged in the marketing and sale of EB-5 investments outside of the U.S. Until such time as the SEC provides specific policies, the EB-5 community is in need of practical advice on how to conduct their business in compliance with U.S. securities laws, and in a way that fits the realities of the EB-5 market.

Based on our experience representing securities issuers, broker-dealers and investment advisers, as well as EB-5 regional centers, EB-5 financing sponsors and developers, here are our suggestions on how EB-5 regional centers and EB-5 offering sponsors can comply with the U.S. securities laws without registration as securities broker-dealers. In addition, here are our thoughts on whether or not to hire a U.S. securities broker-dealer for an EB-5 offering, and whether non-U.S. agents can be hired by EB-5 regional centers and sponsors for offerings conducted outside the U.S.

The SEC regulates who is required to register as a broker-dealer and FINRA regulates those who are registered as broker-dealers

Before discussing exemptions from registration, here is a brief explanation of the basic regulatory framework for U.S. broker-dealers. The Securities Exchange Act of 1934 requires that persons engaged in the business of transacting securities for the account of others register with the SEC as securities broker-dealers. The SEC's stated policy is to require broker-dealer registration of anyone who receives a commission or other compensation in connection with the sale of securities, unless an exemption is available. Some courts have actually taken a different position on this issue, and have ruled that persons who merely act as "finders" are not required to be registered as broker-dealers. However, the definition of "finder" applies only to someone who does nothing more than make an introduction of an investor, which makes this possible exemption very limited. In order for an entity to become a registered broker-dealer, it is necessary for all of the individual persons associated with that entity and involved in brokering activities to take and pass FINRA examinations requiring extensive knowledge of the U.S. securities laws and regulations, and for the registered entity to adopt extensive written supervisory policies and become a member of FINRA. All members of FINRA (which include virtually all registered broker-dealers) are also required to comply with FINRA's own extensive regulations. Registered broker-dealers are also subject to periodic examinations by both the SEC and FINRA, and to sanctions and penalties if the SEC or FINRA find that either the entity or any registered individuals associated with that entity have violated any of the SEC's or FINRA's regulations. Because of these extensive regulations and requirements, most EB-5 regional centers and sponsors will find it difficult if not impossible to become registered broker-dealers.

EB-5 regional centers and managers of EB-5 investment funds are eligible for the issuer exemption from securities broker-dealer registration

SEC Rule 3a-4 provides an exemption from broker-dealer registration requirements for the officers, directors and employees of the EB-5 investment fund that sells interests to EB-5 investors, if the conditions for the exemption are met. The same exemption is also available to the

officers, directors and employees of the manager of the EB-5 investment fund. There are four general requirements that must be met by each person who uses the exemption, which are as follows: (1) the person must have regular duties other than solicitation of investors, (2) the person may not be compensated for the sale of securities (meaning no commissions or bonuses tied to the sale of investments), (3) the person may not be either currently registered with a broker-dealer or have been registered with a broker-dealer for the past 12 months, and (4) the person may not have been the subject of certain prior disciplinary actions, primarily related to prior violations of the U.S. securities laws or regulations. In addition to meeting these general requirements for the exemption, one of three alternative requirements must also be met: (a) the exempt person solicits only broker-dealers or other designated entities that are themselves engaged in the sale of securities, (b) the person participates in no more than one securities offering every 12 months or (c) the person limits his or her participation in an offering to preparing written offering materials and answering questions of investors. The officers, directors and employees of most EB-5 regional centers and sponsors of EB-5 offerings should be able to qualify for this exemption. For active EB-5 regional centers and sponsors, the most common issue is the limitation on participation to no more than one offering every 12 months. In those cases, it is often necessary for the EB-5 regional center or sponsor to forego the direct solicitation of investors, limiting their participation to discussions with brokers, preparation of written documents and answering investor questions. If this limitation applies, then the EB-5 regional center or sponsor must hire other persons to solicit investors for each of their offerings.

Hiring a U.S. securities broker-dealer is one way of soliciting EB-5 investors - but it raises practical issues that are problematic in the EB-5 investment market

An active EB-5 regional center or sponsor that conducts more than one offering every 12 months, and thus is limited to preparing written offering materials and answering EB-5 investor questions under SEC Rule 3a4-1, may hire a U.S. securities broker-dealer to conduct the marketing and solicitation of EB-5 investors. That is one way of complying with the securities broker-dealer registration requirements – in other words, if you don't want to be one, hire one. There are some U.S. securities broker-dealers who have some experience in EB-5 investments and are

actively seeking to become more involved in this market. However, there are some drawbacks to this alternative. First and foremost, U.S. securities broker-dealers cannot solicit investors directly in China, the largest market for EB-5 investments today. China requires that only licensed emigration intermediary service organizations (中介服务机构) be engaged to participate in the sale of EB-5 investments in China. Moreover, there are few if any U.S. securities broker-dealers who are actively involved in EB-5 investment marketing in China. Second, U.S. securities broker-dealers of course expect to receive a commission for their participation in any offering, but overseas agents are unlikely to agree to reduce their compensation in order to share compensation with U.S. securities broker-dealers, which means that the cost of EB-5 financing would need to be increased to cover the cost of hiring both a U.S. securities broker-dealer and overseas agents. Third, U.S. securities broker-dealer are required to comply with FINRA regulations for every securities offering, including EB-5 offerings, and it is unclear how a U.S. broker-dealer is going to be able to comply with these requirements when they are not directly involved with EB-5 investors, particularly in China.

U.S. securities broker-dealers are permitted to engage foreign associates and foreign finders and to share offering compensation with them

U.S. securities broker-dealers are generally permitted to share offering compensation only with other registered broker-dealers or registered associated persons of the broker-dealer. However, in 2001, FINRA's predecessor (the National Association of Securities Dealers) adopted a policy, announced in Notice to Members 01-81 (NTM), allowing U.S. securities broker-dealers to pay commissions to so called "foreign associates" of the broker dealer, or finder's fees to unregistered foreign finders. A foreign associate is an individual person who is registered with the broker-dealer by the filing of a Form U-4 for that individual. The NTM does not require a foreign associate to take the FINRA examinations that are required to be taken by U.S. associated persons, but the U.S. securities broker-dealer is required to supervise all of the securities related activities of the foreign associate. Foreign associates can only be persons, not entities. However, since most EB-5 marketing in China is done through licensed agencies, and these agencies control the activities of their employees, it would likely be difficult for a U.S. securities broker-dealer to use the foreign associate model for selling securities in China in particular.

The NTM defines a “foreign finder” as a non-registered foreign person who refers non-U.S. customers to a member firm. The foreign finder exemption would be easier to use, because it does not require the finder to be registered or subject to supervision of the U.S. broker-dealer, but it requires that the U.S. broker-dealer assure itself that the foreign finder is not required to register in the U.S. as a broker-dealer, and that the compensation arrangement does not violate applicable foreign law. However, if a foreign finder is not required to register as a U.S. broker-dealer, and a U.S. broker-dealer is allowed to pay such a foreign finder, then the EB-5 regional center or sponsor can hire foreign finders directly rather than solely through U.S. broker-dealers.

EB-5 regional centers and sponsors are able to hire non-U.S. brokers to market and solicit investors outside the U.S.

In SECRelease 34-25801 issued in June 23, 1988, the SEC stated that its policy is not to require broker-dealer registration where foreign firms sell U.S. securities exclusively to non-U.S. persons outside the U.S. In fact, the SEC specifically stated in Release 34-25801 that:

“[T]he staff believes that, in contrast to the more expansive scope of the antifraud provisions, the U.S. broker-dealer registration requirements were not intended to protect foreign persons dealing with foreign securities professionals outside the United States. Rather, the primary responsibility for protecting foreign investors from wrongful conduct of foreign securities professionals properly lies with foreign securities regulators.”

In Rule 15a-6, the SEC affirmed its policies as explained in Release 34-25801. Based on this policy, U.S. broker-dealer registration is not required for overseas agents who sell securities solely to non-U.S. persons and conduct their selling activities entirely outside the U.S. There may still be some ambiguity regarding whether a foreign broker-dealer would lose its exempt status if it makes visits to the U.S. to conduct due diligence regarding U.S. projects, or it chaperones foreign EB-5 investors to visit project sites and conduct their own due diligence. In our view, these are not the types of activities that should cause a foreign broker-dealer to lose its exemption from broker-dealer registration under U.S. securities laws. Nonetheless, it would be helpful if the SEC would issue specific guidance on the types of activities that may be undertaken by overseas agents and by in connection with EB-5 offerings.

As explained above, the SEC's existing policies allow EB-5 regional centers and sponsors to hire foreign broker-dealers to sell EB-5 offerings outside the U.S. to non-U.S. persons. Therefore, as long as the foreign broker-dealers do not conduct activities in the U.S. that would cause them to lose their exemption from registration, EB-5 regional centers and sponsors are not legally required to hire a U.S. broker-dealer to conduct EB-5 offerings outside the U.S. In fact, SEC Rule 15a-6 allows a foreign broker-dealer to sell U.S. securities to non-U.S. persons who are temporarily in the U.S. There is no explanation of what is meant by "temporarily in the U.S.," but it might be interpreted to include a non-U.S. person who resides in the U.S. on a temporary visa, such as a student going to school in the U.S. on an F-1 student visa. It would be helpful if the SEC would issue specific guidance on this issue.

How EB-5 regional centers and project sponsors can protect themselves against claims of U.S. securities law violations

EB-5 regional centers and project sponsors who do not wish to register as securities broker-dealers should conduct an analysis of their business and determine how they will comply with the exemption from registration under SEC Rule 3a4-1. They should also determine whether they wish to hire a U.S. securities broker-dealer, and if so, whether they would hire the U.S. broker solely for sales to persons residing in the U.S., or for the entire offering. In addition, they should determine whether to hire foreign broker-dealers for sales of securities outside the U.S., and if so, how they will confirm that the foreign broker-dealer is exempt from registration under U.S. securities laws. Our recommendation is that the EB-5 regional center or sponsor document their policies in writing, so that if the SEC or anyone else asks what their policies are, they are able to present their analysis and reasons why they are exempt from registration. We would welcome the SEC providing clearer guidance on these issues, but in the meantime the SEC's existing policies can be used to structure EB-5 offerings without the need for registration as a securities broker-dealer or for the hiring of U.S. securities broker-dealers.

Part 3: EB-5 Regional Centers— Registration requirements and exemptions under the Investment Company Act



EB-5 Regional Centers: Registration requirements and exemptions under the Investment Company Act

As mentioned in Part 1, “EB-5 offerings do not fit standard SEC registration requirements,” U.S. securities laws were designed primarily for offerings of securities in the U.S. to protect U.S. investors, and these laws are not well suited to the EB-5 investment market. Nevertheless, it is necessary for EB-5 regional centers and sponsors of EB-5 offerings to understand the requirements of U.S. securities laws, and to structure EB-5 offerings in a way that will allow them to qualify for exemptions from the registration requirements. In Part 1 and Part 2 of this booklet, we discussed the requirements for exemption from registration of securities under the Securities Act of 1933 and exemption from registration as a securities broker-dealer under the Securities Exchange Act of 1934. In this Part 3, we discuss the registration requirements and exemptions under the Investment Company Act of 1940 (ICA).

What is an “investment company” under the Investment Company Act?

The ICA generally applies to every public or private company which invests over 40 percent of its assets in securities of one or more other companies, except securities of its own wholly owned subsidiaries. This definition includes any EB-5 fund, whether it is a limited partnership or limited liability company, that invests in the securities of a project company. For example, in the EB-5 “equity” model, if an EB-5 investment fund consisting of EB-5 investors (the new commercial enterprise or NCE, using USCIS terminology) purchases preferred equity interests in the project company (the job creating enterprise or JCE), the fund will be investing in securities of the JCE, and will therefore be deemed to be an investment company under the ICA. Loans are also considered securities under the ICA, meaning that in the EB-5 “debt” model, if an EB-5 investment fund makes a loan to a JCE, the fund will be deemed to be an investment company under the ICA. However, if the EB-5 fund itself owns the project (EB-5 investors are direct equity holders of the JCE), or one of its wholly-owned subsidiaries owns the project (EB-5 investors are equity holders in the fund, and the fund’s wholly-owned subsidiary owns the project), then

the fund will not be considered to be investing in securities, and so will not be an investment company under the ICA. If an EB-5 investment fund meets the definition of an investment company under the ICA, the fund will be required to meet all of the requirements of the ICA, unless the fund is able to rely on one of several exemptions from the ICA, which will be discussed further below.

Could an EB-5 fund comply with the requirements under the ICA if it does not have an exemption?

The simple answer to this is that an EB-5 fund would find it virtually impossible to comply with the requirements of the ICA. Therefore, an EB-5 fund will have to qualify for one of several possible exemptions from the ICA. To understand why it would be so difficult to comply with the requirements of the ICA, here is a brief summary of the major requirements: First, the EB-5 fund (investment company) is required to register its securities offerings with the Securities and Exchange Commission (SEC), and comply with the disclosure requirements under the ICA. The SEC must approve the offering documents before any offering of securities is made. This typically means the investment company will go through a process lasting several months in which the SEC will submit comments and questions before approving the offering documents, which will require multiple revisions to the investment company's offering documents, adding substantial cost and time to the offering process. Following registration, an investment company is required to provide annual and quarterly reports to its investors, including audited annual financial statements, which are also required to be filed with the SEC. The cost of compliance with these registration and reporting requirements is so great that typically only the largest investment funds that seek to raise funds in the U.S. public stock markets will seek to qualify under the ICA.

In addition to these requirements, an investment company is also required to appoint independent directors to fill at least 40 percent of its board of directors, and in some cases must have a majority or super-majority of independent persons on its boards of directors. An investment company is also required to have a registered investment adviser manage its investments. In addition, an investment company is subject to restrictions on transactions with affiliates of the manager. All of these requirements would create substantial additional time delays and costs to the EB-5 investment process. As a practical matter, therefore, it is highly unlikely that any EB-5 fund would ever register under the ICA.

Should the Investment Company Act apply to EB-5 investment funds?

EB-5 investment funds should not be considered investment companies under the ICA, because their investment purpose and method of operation is entirely different than the typical mutual fund that invests under the ICA. A mutual fund is designed to invest in a basket of different securities, and the manager typically has discretion to purchase and sell different investments during the life of the fund. In stark contrast, each EB-5 fund is established to invest in one single project, which is fully disclosed to the EB-5 fund investors at the time of the investment. The manager of each EB-5 investment fund has virtually no discretion to liquidate the original investment and reinvest in a different investment. In fact, the only time that an EB-5 fund manager is typically given any authorization to make a new investment on behalf of the fund is when the original investment is repaid to the EB-5 fund, for reasons outside the control of the EB-5 fund, before the date required by USCIS regulations that the EB-5 investors' investment must be sustained and "at-risk." For example, a JCE that is not controlled by the EB-5 fund manager might be forced to sell a project earlier than planned, or might refinance a project and receive funds in excess of the debt refinanced. As a precaution to protect EB-5 investors, some EB-5 funds authorize the manager to reinvest the proceeds received by the fund in an alternative investment under those limited circumstances. Most EB-5 funds will include provisions in their equity or loan documents that prohibit a project owner from selling or refinancing a project until the date that EB-5 investors are no longer required to hold the investment. Nevertheless, as an additional precaution, it is typical to include a provision that would allow for reinvestment of the proceeds of an investment solely to protect the eligibility of the EB-5 investors for their permanent green cards. This provision is not intended to give broad discretion to EB-5 fund managers to reinvest the funds of EB-5 investors, and in fact the typical EB-5 fund will provide for a distribution of capital back to the EB-5 investors within about five years, after they have fulfilled the "at risk" requirements to obtain their permanent green cards.

Notwithstanding that the ICA was specifically designed for a totally different kind of investment fund than an EB-5 investment fund, the SEC has thus far taken the position that EB-5 funds are subject to the ICA, and are therefore required to comply with the ICA or qualify for one its exemptions. We would urge the SEC to examine this issue further, and to recognize that EB-5 funds are not investment companies under the ICA.

However, until that happens, every EB-5 investment must be structured to comply with one of the exemptions from the ICA, or risk the penalties for violation of the ICA, which include a right of rescission.

What are the possible exemptions available to EB-5 Funds under the ICA?

There are four potential exemptions under the ICA that may be available to EB-5 investment funds. Every EB-5 fund that invests in securities of a JCE that is not a wholly-owned subsidiary of the fund itself will need review each of these exemptions and determine which of them will best suit the requirements of their particular investment. The following is a brief description of each of these possible exemptions:

- **Exemption 1:**
Not more than 100 investors (Section 3(c)(1) Exemption). Every EB-5 fund that has no more than 100 investors will likely qualify for the exemption provided by ICA Section 3(c)(1), which is the exemption for 100 or fewer investors. Since most EB-5 funds are offered at \$500,000 per investment, this means that a maximum of \$50 million can be raised under this exemption. Larger funds need to consider other exemptions. What about splitting an offering of over \$50 million into two funds that each offer the same investment terms? The SEC's position is that it will integrate the offering of two funds if their terms are so similar that they are in fact part of a single offering. However, it would be possible to create two different funds that have different terms of investment that would not be integrated into a single offering, such as by offering one fund first that makes a loan maturing in five years, closing that offering, and then offering a second fund six months later that makes an equity investment with a different preferred return than the first offering, and a different time and method of repayment. It would be very important to structure each of the two funds so that there as many differences as possible in order to avoid an integration of the two offerings. If this is not possible, then it will be necessary to find a different exemption for the entire offering, or to find a different exemption for that portion of the offering that exceeds \$50 million.
- **Exemption 2:**
Direct investment by the Fund in real estate or in a mortgage loan secured by real estate (Section 3(c)(5) Exemption). For those EB-5 funds that will own real estate directly, or will make a loan secured by real estate, the exemption provided by ICA Section 3(c)(5) will likely be available. However, the SEC's position is that this exemption is not available if an EB-5 fund makes an investment

in a JCE other than a wholly-owned subsidiary, even if the JCE owns real estate. This is a problem for any EB-5 fund that invest in preferred equity of an unrelated company that will develop a real estate project. For an EB-5 fund that makes a mezzanine loan to finance a real estate development project owned by a third party, the fund will only qualify for the 3(c)(5) exemption if the fund's loan is secured by a mortgage on the real estate. This can be a problem, because the senior lender to the real estate developer will often not permit a mezzanine lender to take a mortgage in the property, even if it is subordinated to the senior lender.

If the EB-5 fund's loan is secured by the equity interests (membership or limited partnership) in the borrower or property owning company, and the EB-5 fund has many of the same rights as a holder of a mortgage in the property, there is a possibility that the 3(c)(5) exemption might be available. The SEC issued one no-action letter to Capital Trust, Inc. in 2007 in which the SEC found that a mezzanine lender whose loan was secured by equity interests in the property owner met this requirement because (1) the mezzanine loan was made specifically and exclusively for the financing of real estate; (2) the mezzanine loan was underwritten based on the same considerations as the senior secured loan on the property and after the lender performed a hands-on analysis of the property being financed; (3) the mezzanine lender exercised ongoing control rights over the management of the underlying property; (4) the mezzanine lender had the right to readily cure defaults or purchase the senior mortgage loan in the event of a default on the senior mortgage loan; (5) the true measure of the collateral securing the mezzanine loan was the property being financed; and (6) the mezzanine lender had the right to foreclose on the collateral and through its ownership of the property-owning entity become the owner of the underlying property. If an EB-5 fund cannot meet all or most of these conditions, the 3(c)(5) exemption may not be available.

- **Exemption 3:**

EB-5 Fund offered to only "Qualified Purchasers" (Section 3(c)(7) Exemption). An EB-5 fund that seeks to raise more than \$50 million and that does not qualify for the 3(c)(5) exemption may consider using the exemption provided by Section 3(c)(7) of the ICA, which is for funds offered solely to "qualified purchasers." Although the term "qualified purchaser" is defined to include a number of different types of entities, since EB-5 funds are only offered to individuals, only one definition is relevant to EB-5 investors, which is the one for investors with over \$5 million in "investable assets." The term "investable assets" refers to investment securities or investment real estate (other than the investor's primary residence) that are owned by the investor. There

is no requirement that investors provide verification of ownership of “investable assets,” but any EB-5 fund that seeks to use the exemption should require the investor to make a representation regarding the type of investment assets that the investor owns in order to support the use of the exemption. Having this additional qualification requirement is not the most desirable option, since it requires investors to meet higher qualification standards than are normally required for an EB-5 investment. However, in cases where there is no other available exemption, it may be useful. It is also important to note that the SEC does allow concurrent offerings of two related funds where one relies on Section 3(c)(1) and the other relies on 3(c)(7).

- **Exemption 4:**
EB-5 fund which is a “finance subsidiary” of the parent project company (Rule 3a-5 Finance Subsidiaries Exemption). For those real estate developers or other project owners who establish their own EB-5 fund to finance the parent company’s project, the exemption provided by SEC Rule 3a-5 for “finance company” subsidiaries may be available. A finance company is defined as a company that is established by a parent company for the purpose of financing the business of the parent company, and that is owned by the parent company, except for preferred stock with limited or no voting rights that is guaranteed by the parent (which may be subordinated to debt of the parent). This exemption is only available for EB-5 funds that are owned and controlled by the developer of the project being financed with the proceeds of the EB-5 fund, which makes it available only to a small group of EB-5 funds that are owned by the project owners.

How EB-5 regional centers and project sponsors can protect themselves against claims of violation of the ICA

EB-5 regional centers and project sponsors should always consider the ICA potential exemptions when structuring an EB-5 investment. If the offering amount is under \$50 million, the offering will automatically comply with the Section 3(c)(1) exemption. If the offering amount exceeds \$50 million, it will be necessary to find another exemption and structure the offering so that it complies with that exemption. We would welcome the SEC’s recognition that the ICA is not an appropriate law to apply to EB-5 funds because they are in no way similar to the sorts of mutual funds the ICA was designed to regulate. However, unless and until the SEC does adopt such a policy, it is necessary for every EB-5 regional center and sponsor to consider their available exemptions under the ICA.

Part 4:

Investment Advisers Act requirements



Investment Advisers Act requirements

Investment Advisers Act or state law registration requirements for investment advisers may apply to managers of EB-5 funds

In a presentation on securities law issues applicable to EB-5 regional centers and sponsors at the May 2014 annual conference of the Association to Invest In the USA (IIUSA), the trade association for EB-5 regional centers, a representative of the Securities and Exchange Commission (SEC) stated that the registration requirements of the Investment Advisers Act of 1940 (Advisers Act) may apply to general partners and managers of EB-5 investment funds. It was recommended that EB-5 regional centers and sponsors consider this issue as part of their efforts to comply with U.S. securities laws. In our view, the Advisers Act should not apply to most EB-5 regional centers or sponsors, for reasons that relate to the characteristics of EB-5 funds in general. However, unless and until the SEC provides further guidance on this issue, it is necessary for every EB-5 regional center and sponsor to analyze the registration requirements of the Advisers Act and determine if they apply. In addition, the regulation of investment advisers is bifurcated between the SEC, for investment advisers with over \$100 million in assets under management, and the states, for those with under \$100 million in assets under management, and so it is also necessary to determine whether there is a requirement to register as an investment adviser under applicable state law.

Why would the Advisers Act apply to EB-5 regional centers or sponsors if they don't render investment advice to investors in their funds?

Many EB-5 regional centers and sponsors of EB-5 investment funds specifically disclaim in their offering documents that they are giving investment advice to any investors in their funds. However, the Advisers Act and some state securities laws consider the manager or general partner of an investment fund as the investment adviser of that fund, if the fund invests in securities (loans and equity investments in project companies are considered securities). So, even though EB-5 regional centers and sponsors are not providing investment advice to investors,

they may be considered to be providing advice to the EB-5 fund itself. Therefore, unless an exemption from registration is available, the manager or general partner of an EB-5 investment fund that invests in securities may be required to register as an investment adviser under the Advisers Act or applicable state law. For the reasons explained below, we believe that the Advisers Act registration requirement should not apply to EB-5 investment funds, but that it is possible that the manager or general partner of some EB-5 investment funds might be required to register under applicable state law. Even if a manager or general partner of an EB-5 investment fund determines that it may be subject to registration, another option is to retain an independent registered investment adviser to provide any necessary advice concerning securities to the EB-5 investment fund, rather than having the manager or general partner become registered as investment adviser, as is also explained further below.

Until 2012, the Advisers Act had an exemption for any investment adviser with fewer than 15 clients, and a fund was treated as a single client, which meant that many investment fund managers were exempt because they managed fewer than 15 funds. Many states had similar exemptions based on the number of clients in the state, and many states still have these exemptions, but the number of investors permitted under each state's laws vary.

The Advisers Act was amended as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act adopted in 2010. As a result, since 2012, managers of "private funds" with "assets under management" (or AUM) in excess of \$150 million are now required to register with the SEC under the Advisers Act, and those with AUM between \$100 million and \$150 million are required to file but not be registered with the SEC as "exempt reporting advisers." Those with AUM under \$100 million are directed to register under applicable state laws if required under those laws. Each manager or general partner of an EB-5 fund needs to determine first whether it is a manager of "private funds," and if so, what is the amount of its AUM.

What is a "private fund" under the Advisers Act?

A "private fund" is defined under the Advisers Act as a private investment fund that would be required to be registered under the Investment Company Act of 1940 but for the exemptions provided under Sections 3(c)(1) or 3(c)(7) of that Act. (See Part 3 for more information about those exemptions.) According to this definition, an EB-5 investment fund that is

exempt under Section 3(c)(5) of the Investment Company Act, because it invests only in real property or in loans secured by real estate, would not be defined as a “private fund” under the Advisers Act. However, an EB-5 investment fund that invests in equity securities of a project company (other than a wholly-owned subsidiary of the EB-5 fund), or makes a loan to a project company that is not secured by real estate, since it will be relying on the exemptions under Sections 3(c)(1) or 3(c)(7), will be considered a “private fund” under the Advisers Act.

What happens if an EB-5 regional center or sponsor manages several EB-5 funds, and some of them are exempt under 3(c)(1) of the Investment Company Act, but others are exempt under 3(c)(5) of the Investment Company Act?

This is not an uncommon situation for many EB-5 regional centers or sponsors, but the answer to this question gets tricky because of an exemption from registration under the Advisers Act adopted by the SEC in 2011 for advisers of “private funds” with less than \$150 million in AUM, under SEC Rule 203(m)-1. The exemption is for persons who are managers “solely” of “private funds” with AUM under \$150 million. An adviser that has one or more clients that are not “private funds” is not eligible for the exemption. In order to provide the benefit of the exemption to advisers who manage funds exempt under 3(c)(5) as well as funds exempt under 3(c)(1) and 3(c)(7), the Rule states that an adviser can treat funds exempt under 3(c)(5) the same as funds exempt under 3(c)(1) and 3(c)(7), and still be exempt. If a manager or general partner does manage both types of funds, it would include potentially all of the AUM of all EB-5 investment funds managed by that manager or general partner.

Is each EB-5 fund considered separately, or are all EB-5 funds aggregated to determine the total AUM under management?

All EB-5 funds that are managed by a manager or general partner would be aggregated for purposes of determining the total AUM managed by that manager or general partner. For this purpose, even if separate legal entities are formed to act as the manager or general partner of each EB-5 fund, the SEC will generally treat all entities that are under common ownership and control as a single entity. This means that,

in order to determine the amount of AUM, the assets of all EB-5 funds that are managed by entities under common ownership and control must be aggregated.

What are “assets under management” under the Advisers Act?

The Advisers Act defines “assets under management” (or AUM) as the “securities portfolios” with respect to which an adviser provides “continuous and regular supervisory or management services,” which means there are two parts to this definition. The first part is whether an EB-5 investment fund holds “securities portfolios.” According to the SEC’s definitions under the Advisers Act, a manager of a “private fund” is required to treat all of the assets of the fund as part of its “securities portfolio,” even if some of the assets are real estate. (The rule is different for managers of individual accounts, where assets are counted only if the account portfolio is over 50 percent invested in securities, but that is not relevant for the purpose of EB-5 investment funds.) So, for this purpose, if an EB-5 fund is classified as a “private fund,” then 100 percent of its assets are considered part of its “securities portfolio,” even if the assets are not technically “securities.”

The second part of the definition – whether assets are under “continuous and regular supervisory or management services” – is the key to whether EB-5 investment funds will have AUM sufficient to require registration under the Advisers Act. According to the SEC’s specific instructions for calculating AUM, the SEC states that making an initial asset allocation, without continuous and regular monitoring and reallocation; or providing advice on an intermittent or periodic basis (such as in response to a market event, or on a specific date) is not considered “continuous and regular supervisory or management services.”

Do the managers of EB-5 funds provide “continuous and regular monitoring” of assets?

Because of the requirements of the EB-5 program, virtually every EB-5 investment fund makes one initial investment, which is fully disclosed to all investors, and that is the sole investment ever made by the fund. The only time that an EB-5 investment fund might potentially make another investment would be in the event of an early repayment by a project company to the EB-5 investment fund, if the fund manager determined

that it might protect the EB-5 investors' eligibility for I-829 petition approvals if the proceeds were redeployed to another investment. That would generally be a rare event, and according to the SEC's instructions, would not qualify as "continuous and regular supervisory or management services." *Therefore, under the SEC's definition of AUM, virtually all EB-5 fund managers would be exempt from SEC registration under the Advisers Act, because they do not provide "continuous and regular supervisory or management services" over the assets in the EB-5 funds that they manage. We therefore believe that it would be rare for any manager or general partner of an EB-5 investment fund to have sufficient AUM to qualify for SEC registration under the Advisers Act.*

Are state investment adviser registration requirements applicable to managers of EB-5 investment funds?

The answer may be yes in some states, and no in other states. Each state has different rules for registration of investment advisers, and they are not all modeled on the federal Advisers Act. It is first necessary to determine what state's laws apply to a manager, and that is typically the state where the principal place of business of the manager is located, and may also include one or more other states if the principal place of business of the EB-5 investment funds are located in states other than the state where the manager or general partner has its office. When the relevant states are determined, it is then necessary to review the laws of those states to determine if there are possible exemptions based on the number of funds being managed. In some states, such as California, a manager of even one investment fund may be required to register, but there is an exemption for managers of private funds that is similar, but not identical to the federal exemption for private fund advisers. In other states, no registration is required unless the manager has over a certain number of clients, with each fund counting as a single client for this purpose.

In addition to the possible stated exemptions from registration under state law, there is also an overriding question of whether the manager or general partner is in fact providing investment advice to its EB-5 funds, since these funds typically make one investment for the life of the fund, with a possible reinvestment only if necessary to preserve the eligibility of the EB-5 investors for their I-829 petition approvals. It may be possible to obtain advice from the relevant state securities agency that under these

circumstances registration is not required.

The other option that may be considered by managers or general partners of EB-5 investment funds is to retain a registered investment adviser to provide investment advice to the funds. Since there is only one initial investment decision, and a possibility of a reinvestment decision that could be triggered by an early disposition of a fund's investment, it does not appear that the role of the registered investment adviser would extend beyond the initial investment and any subsequent reinvestment.

What should EB-5 Regional Centers and Sponsors do?

Every EB-5 fund manager or general partner should analyze whether they would be required to register as an investment adviser under the laws of the state where their principal place of business is located, or whether they qualify for an exemption from registration. In addition, they should determine what conditions may apply to be eligible for the exemption. As indicated above, we do not believe that the Advisers Act should apply to most if not all managers or general partners of EB-5 funds, because they do not exercise "continuous and regular supervisory or management services" over the assets of EB-5 funds. Based on the SEC's instructions for making this determination, it does not appear that managers or general partners who managed only EB-5 funds would even be eligible to register, because their role in the investment decisions of these funds is so limited that they would not have the required amount of AUM. We would encourage the sponsors of EB-5 funds to seek an acknowledgement of this conclusion from the SEC.



REGIONAL CENTERS & SPONSORS AND U.S. SECURITIES LAWS

**How to evaluate broker-dealer, investment company
and investment adviser registration requirements**

JMBM's Investment Capital Law Group

Catherine DeBono Holmes

Chair, Investment Capital Law Group
Jeffer Mangels Butler & Mitchell LLP
CHolmes@jmbm.com
www.jmbm.com
+1-310.201.3553

The lawyers of JMBM's Investment Capital Law Group represent real estate developers, EB-5 regional centers, private fund managers and registered broker dealers regarding their U.S. real estate projects and investments.

Visit us online at

www.jmbm.com/investment-capital-law-group

Advantage America EB-5 Group

Victor T. Shum, Esq.

CEO, Advantage America EB-5 Group
vshum@aaeb5.com
www.aaeb5.com
+1-415.886.7486

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